Environment and Energy and Finance Committees

Key Messages on
Efforts to develop sustainable finance definitions and taxonomies

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Well-designed sustainable finance definitions and taxonomies may help foster transparency, long-terminism and strengthen sustainable growth. In this context, it is important for *Business at OECD* that the following issues are considered and addressed when defining a legislative taxonomy initiative:

1. **Ensure a holistic and inclusive approach towards a net zero-carbon economic system:** It is important that taxonomy compliance criteria for transition activities and enabling activities are carefully assessed, in order not to trigger unintended carbon lock-in effects and to limit the possibility of funding sustainable investments by investors or banks. Proper and cautious consideration should be given to those activities that may not be zero-carbon but might be needed in the path towards net zero-carbon and Paris Agreement-aligned economic systems. Holistic taxonomies should include all transition and enabling activities, and consider how the strengths and potential of carbon intensive sectors can be leveraged to competitively and sustainably serve the market needs of the future while ensuring the achievement of climate policy objectives. The principles of technology neutrality, cost effectiveness and free competition should be underlined to allow all sectors to take part in the transition.

2. **Set evidence-based and appropriate compliance thresholds and targets:** Where thresholds and targets for activities under the taxonomy are determined, these should be evidence-based and appropriately set. To reflect technological and scientific developments, it is also important that these are regularly revised and updated in a swift manner. A further relevant issue to be considered is whether an assessment of a company should have a credit rating separated from a sustainability rating or whether an integrated rating is required. We highlight the need for credit ratings to be based on the financial merits of a company. Integrated ratings run against the limits and boundaries of a classification system where the credit risk of default rating can be undermined (e.g. a "greener" company gets favored in a credit ratings despite poor financials). A similar argument applies when for example capital requirements of bank and insurance companies would be impacted by sustainability factors.

3. **Avoid burdensome compliance verification:** Taxonomies should stand on administrative processes that are as simple as possible. Unfortunately, verifying taxonomy compliance of activities and/or investment often involves a burdensome and complex process for business, and in this context regulation should well balance the amount of data requested from different players (SMEs, listed companies, etc.) with end-users adequate access to information. Encouraging SMEs to participate in the transition could be facilitated if, at least for a certain period, the threshold of the screening criteria could be loosened up for this kind of players or other flexibility mechanisms are contemplated.

4. **Enhance usability and data availability:** Taxonomy and disclosures duties should be closely linked. Concerning the EU framework, the disclosures duties foreseen for the

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financial market participants according to the taxonomy regulation should be aligned with the disclosure duties foreseen for the industrial sectors in the upcoming review of the EU's Non-Financial Reporting Directive (NFRD). Furthermore, besides the effort to improve the data collection and data quality, market participants will need an approach to comply with disclosure requirements that is as automated as possible: taxonomy usability is a central issue. In this regard, further alignment of public and private taxonomies would be beneficial, in order not to generate double accounting of sustainable activities and facilitate the usage by banks of public data and vice-versa.

5. **Widen the definition of climate finance products to include *Transition Finance*:** A wider definition of climate finance products should include *Transition Finance*, either based on "use of proceeds" (i.e. transition bonds) or "general corporate purposes" (i.e. SDG KPI-linked bonds related to the issuer's global sustainability strategy) formats. This wider definition should be extensive to a more flexible Taxonomy to allow all companies committed to transition to have access to sustainable finance.

6. **Reduce fragmentation across taxonomies, definitions and markets, but avoid a "one-size-fits all" approach:** Different standards may result in market fragmentation, which in turn may negatively affect sustainable investment. Thus, to facilitate the funding of investment and foster efficiency, it is important to strengthen efforts to converge the multiplicity of taxonomies and definitions as many investors, banks and corporates operate on a global scope. However, at the same time a degree of flexibility in the definition of a "sustainable activity" may still be necessary to capture diverse circumstances and it is important to avoid a "one-size fits all" approach. When striking the right balance, it is important that taxonomies should not be mandatory but once in application by a corporate or financial company, must be globally comparable. Taxonomies should be designed in a non-discriminatory manner and elements might be considered to be inclusive of partner countries' regions and markets[1]. In this context, it is key to consider that business activities can affect the environment on a local (i.e. water and suspended microparticles) and a global level (CO_2 emissions), and similar business activities can have different effects if in different geographies. This is also why impacts might be related to "where" an investment is localized when developing new market mechanisms such as disclosure of carbon content as a product parameter.[2]

[1] For example, one may argue that a specific country's sectors are at risk of being excluded from *Green* and *Transition* financial products and services, because green taxonomies developed by certain countries around the world do not recognize several natural-resource sectors of the country as being *Green* or *In Transition*. So the taxonomy and definition of *Green* needs to include a flexible transition definition/period - otherwise with focusing primarily on being holistic/global you may unintentionally exclude various countries in the process.

[2] To the extent that this convergence does not take place or takes time to achieve, *Business at OECD* members would welcome a reflection on impacts resulting from this situation. This is especially important as different decarbonisation pathways can be embedded in different taxonomies which may lead to the classification of some activities as sustainable in one taxonomy, but not in others and thus result in the shifting of financial resources between different taxonomies. In this regard, we would like to point to the work undertaken under the System for Environmental Economic Accounting (SEEA) (4) that is being managed at UN and OECD level, and endorsed by the EU, IMF and other financial institutions - as a good basis to integrate definitions and align reporting of similar data by States, Banks and Financial Institutions [In this regard we would like to also highlight the recent article "A common language for sustainability data: a Taxonomy and a nomenclature" from the Joint Research Council of the European Union, written by Hans Biemans, ING Bank & Chair of taxonomy working group of the European Banking Federation (link), which discusses a common language for sustainability data that combines sustainability criteria and existing nomenclatures to classify them. EU member states are obliged to report their annual accounts according to this system, so a possible alignment of state disclosures with financial institution disclosures can be achieved. This system also ensures that the international dimension is covered, as it is maintained by UN & OECD. [See latest coordination works here: https://seea.un.org/events/5th-joint-oecdunece-seminar-implementation-seea and the alignment of the SEEA with SDG targets:
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